Memorandum

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DNR [Diarienummer]

Higher capital requirements for the major Swedish banking groups

The Riksbank considers that higher capital requirements should be set for the four Swedish banking groups, Handelsbanken, Nordea, SEB and Swedbank. If we use the definitions in the Basel III Accord, the Riksbank considers that the requirement for common equity Tier 1 capital should amount to 10 per cent of risk-weighted assets with effect from 1 January 2013, and to 12 per cent from 1 January 2015. These capital ratios include the capital conservation buffer of 2.5 per cent, but not the contracyclical buffer. The proposed higher requirements reduce the systemic risk in the Swedish financial system and increase confidence in the Swedish banking system. The Swedish banking groups have good opportunity to meet these higher requirements for common equity Tier 1 capital. This memorandum provides the background to the Riksbank's position regarding new capital requirements for the Swedish banks.

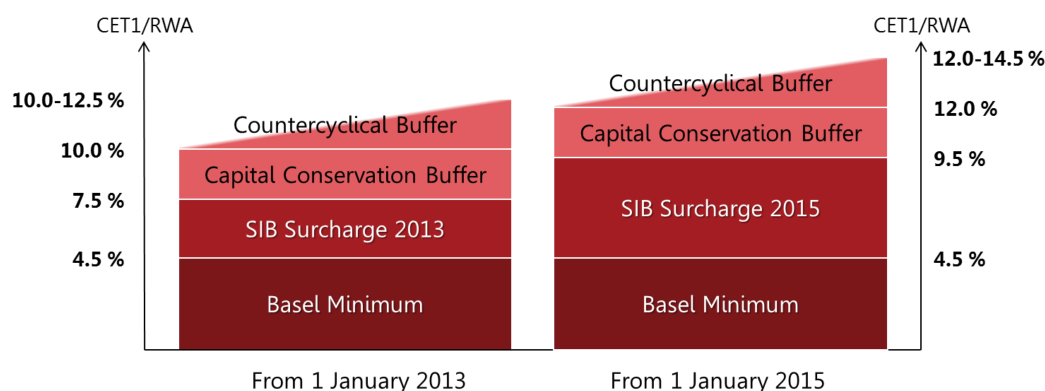
Reasons for the regulations

The Riksbank considers that the capital requirement for the four major Swedish banking groups, Handelsbanken, Nordea, SEB and Swedbank should be higher than the minimum proposed by the Basel Committee for Banking Supervision in the Basel III regulations to increase the financial system's resilience to new crises and to ensure that the banks are better equipped to meet a potential financial crisis.

If we use the definitions in the Basel III Accord, the Riksbank, the Ministry of Finance and Finansinspektionen consider that the requirement for common equity Tier 1 capital should amount to 10 per cent of risk-weighted assets with effect from 1 January 2013, and to 12 per cent from 1 January 2015.[1] These capital ratios include the capital conservation buffer of 2.5 per cent, but not the contracyclical buffer.

[1] The ratio between core Tier 1 capital and risk-weighted assets is also referred to as the core Tier 1 capital ratio, for instance, in the Riksbank's Financial Stability Report.

Future requirements regarding CET 1 capital for the major Swedish banks, in comparison with the Basel III requirements



Note: The requirements refer to CET 1 capital in relation to risk-weighted assets defined in accordance with the Basel III Accord. Note that a countercyclical buffer may, under certain circumstances, reach levels above the equivalent of 2.5 per cent of risk-weighted assets.

Source: The Riksbank

The reason why the Riksbank, the Ministry of Finance and Finansinspektionen are advocating higher capital adequacy requirements for the four major Swedish banks is that there are circumstances in the Swedish banking system that entail risks not fully covered by the Basel III regulations.

- One circumstance is that the Swedish banking system is so concentrated. This means that the major Swedish banks have large exposures to one another, primarily through interbank loans and holdings of one another's covered bonds. Risks arising in a single bank's operations can thereby easily spread to the other major banks.
- Another circumstance is that the major Swedish banks have a large share of market funding in foreign currencies. Unexpected negative events or disruptions on the international financial markets can thus cause considerable problems for the major banks and ultimately for the Swedish economy.
- A third circumstance is that the market assumes that the major banks have an implicit guarantee from the government (what is known as the "too-big-to-fail" syndrome), which means they can obtain cheaper funding than would otherwise have been the case. The implicit government guarantee thus risks leading to incorrect pricing of credit. This can in turn lead to an excessively high growth in credit and to the build-up of imbalances in the financial system.
- A fourth circumstance is that the Swedish banks are large in relation to the Swedish economy. One reason for this is that they have extensive operations abroad. At the same time, there are no effective international agreements on how to manage large cross-border banking groups in a crisis situation. This means that the failure of a major Swedish bank risks being difficult to manage and could create uncertainty as to how the costs would be distributed between the countries involved.

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All in all, these circumstances mean that if one or more major Swedish banks had to be saved from failure with the aid of government resources, there is a risk of substantial costs for society as a whole. The costs may arise in the form of direct public expenditure for recapitalisation and discharged guarantees, and also in the form of large falls in production that often come in the wake of a financial crisis.

Higher capital requirements would mean that the banks' resilience to failure increases, at the same time as shareholders would have to bear a greater portion of the cost if a bank failed. In addition, higher capital requirements would make it easier for the banks to obtain access to market funding in a situation where the financial markets are stressed. The banks would thus have better ability to manage stressed situations without public sector intervention.

However, higher capital requirements could also entail costs to society in the form of dearer bank services and more restricted credit granting. Such costs must be weighed against the long-term benefits of higher capital requirements in terms of less frequent and costly systemic crises.

The circumstances above imply that both the risk of problems in a major bank developing into a systemic crisis, and the ensuing social costs are higher for Sweden than for many other countries. There is thus even more reason to reduce the risks of a crisis in Sweden by introducing higher capital requirements. An overall assessment implies that the social benefits are greater than the costs. Other countries, such as Switzerland, the United Kingdom and Austria, have also argued in favour of higher capital requirements than the minimum stated in the Basel III Accord, for similar reasons.

The Swedish banking groups currently have high capital adequacy from an international perspective, and are relatively close to the ratios proposed here. Even with a conservative assessment, the banks thus have good chances of attaining the proposed common equity Tier 1 capital ratios. The proposal thus reduces the systemic risk in the Swedish financial system and increases confidence in the Swedish banking system.

The proposal in relation to international regulations

The global Basel III Accord states the minimum requirement for the capital adequacy regulations that each country should introduce. The Basel III Accord is not formally binding for Swedish banks. It must be implemented into national law through the EU laws or Swedish legislation. For this purpose the European Commission has proposed a number of changes regarding EU regulations on capital adequacy in credit institutions and securities companies, leverage and liquidity.

The Basel III Accord allows each country the scope to introduce higher requirements for its banks, on the basis of the country's own specific conditions. However, it is still an open question as to whether the individual member states should have the right by law to apply higher capital requirements than those prescribed in EU legislation.